

March 11, 2011

Advance copy by email.

The Honorable George Runner
California State Board of Equalization
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Re: California Affiliate Tax Nexus Legislation

Dear Mr. Runner,

I'm responding to your request for information concerning the affiliate tax nexus legislation now pending in the California assembly. You asked about our intended business response.

If it passes, we will respond to the legislation by terminating our relationship with California-based affiliates. We have done this in every state where this legislation has passed, and we will do so in California. In fact in 2009, when the California legislature passed a similar law, we terminated all our California affiliate contracts until the legislation was subsequently vetoed. It is a business decision that, though regrettable, is relatively straightforward and uncomplicated.

The reason for this is simple: Affiliate ad terminations in a given state do not affect our sales, our ability to advertize locally, or any other aspect of our business. Since the Internet is borderless, there is no advantage to using a California affiliate over any other. Thus, when one state closes its doors by passing an unconstitutional tax law, it is as easy as throwing a switch to walk that business through the open door of some other state and hand that business to the affiliates located there. Since we have done that in each instance following the passage of these laws, and have done it once before in California, no one should believe we would not do so again.

In New York, where such legislation first passed, we terminated our affiliate relationships at the moment the law became effective. Our business in New York did not change: our ads are still seen by New York customers, we still sell to New York customers, and we do not collect nor remit any New York sales tax. There were only two known effects the New York affiliate tax nexus law had relating to Overstock.com: First, the millions of dollars we formerly spent in payments to New York resident advertisers shifted to advertisers in other states; and second, we sued New York. We are still suing, and believe we will ultimately succeed.

The number of California affiliates with whom we do business has fluctuated. In 2009, when the California legislature first passed this legislation, we had as many as 3,200 affiliates in California. I was surprised to learn today we now have approximately 600. We still have a sizable ad budget there, but only one-fifth of the affiliate numbers previously. Without knowing exactly the cause of the decline, it is difficult not to conclude that some part of the decline might be properly attributed to the threat of this legislation in 2009, but I do not know for certain. In any event, I would think that whatever the reason, the decline of affiliates ought to be alarming, especially in light of the fact that the affiliate ad business ought to be the type of business California would want to cultivate: it doesn't pollute, and it pays well.

There are always a number of disinformation clouds following this affiliate tax nexus legislation wherever it goes. I'd like to clear away least a couple of those clouds.

First, some legislative proponents often suggest that what we are threatening, in reality, is that we will not sell nor advertize in a given state if such a law passes. That is not true. This "paper tiger" argument is then summarily knocked down when its creator points out that a state, like California, is too big for that. As I have pointed out, the only business we will not do is in paying resident California advertisers. In every other way our business will be normal. This argument was made in Illinois recently in a flurry of legislation that accompanied the final push to get it passed. Yesterday, the Illinois Governor signed the bill into law; yesterday, Overstock.com gave notice to Illinois affiliates that we were terminating their services in a little over a month—long before the law goes into effect on July 1. We did not terminate these agreements immediately as several larger advertisers informed us they needed time to remove their business to another state.

Second, some legislators and other proponents have attempted to "cheer up" affiliates by saying that though they might lose their Amazon or Overstock.com "jobs," Wal-Mart and other big box-store retailers have offered to "take them on." The rhetoric of "jobs" is cleverly alluring in hard times, but the offer is illusory. Affiliates understand that they are not our employees, and the real effect of this legislation will prevent them from competing for the large ad budgets of some leading Internet retailers—no matter what Wal-Mart does. Internet ad affiliates are not NFL players—they play for all the retailing teams at the same time, and they likely already serve ads for Wal-Mart and the other offerors involved. Consequently, unless Wal-Mart and the others are willing to guarantee to make up the difference in the advertizing revenue shortfall from retailers like Amazon and Overstock.com, the offer means very little.

I hope the information I have provided answers your questions and clears up some of the misconceptions. If I can be of further assistance, please do not hesitate to contact me.

Very truly yours,

A handwritten signature in black ink, appearing to read 'mjg', written in a cursive, fluid style.

Mark J. Griffin
General Counsel

MJG:gg

cc: